Lightship Holding, Inc.

Notes to Consolidated Financial Statements

December 31, 2003 and 2002

1. The Company

Lightship Holding, Inc. (Lightship) is a Delaware corporation that is the sole member of Lightship Telecom LLC (Telecom), a Delaware limited liability company. Telecom is a competitive local exchange carrier (CLEC) that provides telephony services to small-and medium-sized businesses within the New England area.

The consolidated financial statements incorporate the business activities of Lightship and Telecom. As used herein, the term "Company" refers collectively to Lightship and Telecom. All intercompany accounts or balances have been eliminated in consolidation.

Lightship has incurred losses from operations since its inception and has an accumulated deficit of $59,767,770 as of December 31, 2003. It expects to continue to incur net losses during 2004, primarily due to depreciation, amortization and interest expenses. The Company's management believes the $5,806,845 cash balance, and anticipated future operating revenues, will be adequate to fund operations as contemplated in the Company's current long-range business plan.

In February 2002, the Company sold shares of Series CC Voting Convertible Preferred Stock (Series CC), recapitalized its existing capital stock into Series BB Voting and Non-voting Convertible Preferred Stock (Series BB) and Series AA Voting Convertible Preferred Stock (Series AA), converted outstanding subordinated notes into Series BB shares and restructured its credit facility with its senior lender (see Notes 5 and 7). Certain amounts in the December 31, 2002 financial statements have been reclassified in order to keep the information from being misleading.

2. Summary of Significant Accounting Policies

The accompanying consolidated financial statements reflect the application of certain significant accounting policies as described in this note and elsewhere in the accompanying consolidated financial statements and notes.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results may differ from those estimates.

As disclosed in the accompanying notes to the financial statements, effective January 1, 2003, the Company revised the estimated useful life of computer equipment and software from 5 years to 3 years to more accurately reflect their service period and conform to industry norms. This change in accounting estimate resulted in a $43,733 increase in depreciation expense for the year ended December 31, 2003.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash equivalents are stated at cost, which approximates market value.

Revenue Recognition

Revenues from operations consist of charges to customers for local access, long-distance, carrier access and data services. Revenues are recognized as services are rendered, in accordance with Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* (SAB 104). Unbilled revenues result from services provided from the billing cycle date to the end of the month that have not yet been billed. Access revenues billed in advance are deferred and are recognized in the period earned.

Historically, the Company has recognized installation fees as the services were rendered. However, in 2002, the FASB issued EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), which provides guidance on the timing and method of revenue recognition for sales arrangements that include the delivery of more than one product or service. Under EITF 00-21, revenue must be allocated to all deliverables regardless of whether an individual element is incidental or perfunctory in proportion to its relative fair value. The relative fair value of a product or service is defined as the price at which the item can be sold separately, or objective evidence of fair value. If objective evidence of fair value has not been established for all items under the arrangement, no allocation can be made, and all elements must be

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

recognized over the term of the arrangement. Upon the adoption of EITF 00-21, the Company was not able to assign fair value to the installation services, as they are never sold independently of the other services. As a result the Company has changed its accounting policy whereby it now defers the installation fees upon billing, and amortizes the fees on a straight-line basis over three years which approximates the average customer contract life. The Company has presented this change of $544,254 as of January 1, 2003 as a cumulative effect of a change in accounting principles as a separate component of net loss, as required by APB No. 20, *Accounting Changes* (APB 20). The deferred revenue balance of approximately $644,000 as of December 31, 2003 will be amortized over estimated customer life of three years.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is provided for financial reporting purposes using the straight-line method over the following estimated useful lives:

Asset Classification	Estimated Useful Life
Computer equipment and software	3
Telecommunication switching and other equipment	5
Office furniture, fixtures and equipment	5
Billing and operating system software	5
Leasehold improvements	Lease term

Effective January 1, 2003, the Company revised the estimated useful life of computer equipment and software from 5 years to 3 years to more accurately reflect their service period and conform to industry norms. This change in accounting estimate resulted in a $43,733 increase in depreciation expense for the year ended December 31, 2003.

Maintenance and repairs are expensed as incurred. Expenditures for major renewals and betterments that extend the useful life of the related asset are capitalized and depreciated. When the property or equipment is retired or otherwise disposed, related costs and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in operating income/loss.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The estimated fair value of these financial instruments approximates their carrying value as of December 31, 2003.

Impairment of Long-Lived Assets

Based upon the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), the Company reviews assets for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. A determination of impairment is made based on estimates of future undiscounted cash flows. Measurement of any determined impairment is based on future discounted cash flows or an estimate of fair value. As of December 31, 2003, the Company does not believe any of its long-lived assets have been impaired.

Employee Benefits

The Company has established a 401(k) savings plan (the 401(k) Plan) in which employees of the Company are eligible to participate. The 401(k) Plan allows the Company to make contributions to the 401(k) Plan at its discretion. There were no Company contributions in 2003 or 2002.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses charged to operations were $277,190 and $269,019 in 2003 and 2002, respectively.

Income Taxes

The Company provides for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes* (SFAS 109). SFAS 109 is an asset and liability approach that requires recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax basis, and for operating loss and tax credit carryforwards. In estimating future tax consequences, SFAS 109 requires consideration of all expected future events other than the enactment of changes in tax laws or rates.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Since electing to be taxed as a corporation on February 29, 2000, Lightship has incurred net operating losses (NOLs). As of December 31, 2003, the accumulated NOLs were in excess of $19 million, resulting in the recognition of a deferred tax asset. The Company has also recorded a full valuation allowance since it appears more likely than not that the Company will not be able to utilize the deferred income tax asset. The losses incurred by the Company from 2000 to the date of the recapitalization (see Note 7) may be subject to limitations under Section 382 of the Internal Revenue Code. The Company has not yet completed the analysis required to substantiate the amount.

Stock-Based Compensation

The Company accounts for its stock-based plans under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and provides pro forma disclosures of the compensation expense determined under the fair value provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Under APB 25, when the exercise price of options granted under these plans equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. In accordance with Emerging Issues Task Force (EITF) 96-18, the Company records compensation expense equal to the fair value of options granted to nonemployees over the vesting period, which is generally the period of service.

The following table illustrates the effect on the net loss if the Company had applied the fair value recognition provisions of SFAS 123 for the period ended December 31, 2003.

Net loss, as reported	$(4,261,233)
Stock-based compensation expense included in reported net loss	6,736
Deduct: Total stock-based employee compensation expense determined under the fair value-based method for all awards	(1,773)
Pro forma net loss	$(4,256,270)

The weighted-average per share fair value of options granted during 2003 was $0.08.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The fair value for these options was estimated at the date of grant using the "minimum value method" prescribed by SFAS 123. The following weighted-average assumptions were used to determine the fair value:

Risk-free interest rate	2.87%-3.77%
Expected Dividend	-%
Expected volatility	-%
Weighted-average expected life	7 Years

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to a concentration of credit risk, principally consist of cash and cash equivalents and trade accounts receivable. The Company has its cash and cash equivalents placed with a high quality, creditworthy financial institution. The balances at such institution met federally insured limits. Concentrations of credit risk arising from trade accounts receivable are limited due to the large number of customers in its base and their dispersion across various industries. At December 31, 2003 and 2002, the Company had one customer that accounted for 29% and 20%, respectively, of the accounts receivable and unbilled revenue. During the years ended December 31, 2003 and 2002, the Company had one customer that accounted for 20% and 13%, respectively, of revenues. As is common in the industry, the Company leases a significant portion of its network elements from a single incumbent local exchange carrier (ILEC).

Comprehensive Loss

Comprehensive loss is defined as the change in stockholders' equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. The comprehensive loss for all periods presented does not differ from the net reported loss.

Recent Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150). SFAS 150 affects the issuer's accounting for three types of freestanding financial instruments. SFAS 150 also requires disclosures about alternative ways of settling the instruments and the capital structure of entities, all of whose shares are mandatorily redeemable. This statement is effective for financial

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities, for which it is effective for the first fiscal period beginning after December 31, 2003. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the statement and still existing at the beginning of the interim period of adoption. Restatement is not permitted. The Company has not yet assessed the effect of adopting SFAS 150.

3. Installation Charges

The Company capitalizes installation charges paid to an ILEC for the connection of leased-line facilities within the Company's network and to end-user customer facilities. The Company recognizes these costs in amortization expense over a three-year period, which approximates the expected life of the customer. Installation charges consist of the following at December 31:

	2003	2002
Capitalized installation charges	$ 2,571,416	$1,622,359
Accumulated amortization	(1,449,545)	(802,754)
	1,121,871	819,605
Less current maturities	(555,778)	-
Long-term portion of installation charges	$ 566,093	$ 819,605

The amount charged to amortization expense relating to installation charges during 2003 and 2002 was $647,339 and $430,759, respectively.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

4. Property and Equipment

Property and equipment consists of the following at December 31:

	2003	2002
Telecommunications switching and other equipment	**$ 28,331,321**	$ 24,821,021
Billing and operating system software	**1,740,407**	579,246
Office furniture, fixtures and equipment	**961,956**	901,846
Computer equipment and software	**2,166,074**	1,762,345
Leasehold improvements	**1,014,145**	997,410
Construction in progress	**-**	605,100
	34,213,903	29,666,968
Less accumulated depreciation and amortization	**(18,010,297)**	(11,848,911)
Property and equipment, net	**$ 16,203,606**	$ 17,818,057

Depreciation and amortization expense relating to property and equipment was $6,179,925 in 2003 and $5,366,654 in 2002. Effective January 1, 2003, the Company revised the estimated useful life of computer equipment and software from 5 years to 3 years to more accurately reflect their service period and conform to industry norms. This change in accounting estimate resulted in a $43,733 increase in depreciation expense for the year ended December 31, 2003.

As of December 31, 2002, the Company had recorded in construction in progress (CIP) costs associated with two in-house billing systems totaling $605,100. Of these costs, $97,300 was for a carrier access billing system implemented in the first quarter of 2003 and $507,800 was for an end-user billing system implemented in the second quarter of 2003. These costs were transferred to property and equipment and began depreciating when the respective systems were put in service in a production environment. Costs associated with the implementation of the billing systems were capitalized, while costs associated with training and migrating data from existing systems were expensed as incurred.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt

Long-term obligations at December 31 consist of the following:

	2003	2002
Credit facility	**$27,735,076**	$26,233,591
Capital lease obligations	**44,822**	99,053
	27,779,898	26,332,644
Less current maturities	**(2,787,769)**	(86,878)
	$24,992,129	$26,245,766

On September 26, 2000, the Company entered into a Loan and Security Agreement (Credit Facility) with its senior lender. The Credit Facility provided for a $24,000,000 loan, collateralized by substantially all of the Company's assets, which may be drawn in any number of installments. For each installment drawdown, the interest rate is either LIBOR plus 4.75% or the base rate. The base rate is determined by the highest of prime plus 3.75% or the fed funds rate plus .5%. The interest rate is determined at the inception of each installment loan. If the LIBOR rate is chosen, interest payments will begin immediately. If the base rate is chosen, there is a 10-month deferment of interest payments.

On December 27, 2000, Lightship received an aggregate $20,000,000 from two of its stockholders in exchange for the issuance by Lightship of subordinated promissory notes in the aggregate principal amount of $20,000,000. In accordance with their terms, the subordinated notes were convertible into equity of Lightship. In connection with the closing of the transactions under the Equity Agreement on February 8, 2002 (see Note 7), the principal balance of the subordinated notes outstanding were converted into Series BB Convertible Preferred Stock, and $1,886,311 in accrued interest on the subordinated debt was included as additional paid in capital.

Concurrent with the closing of the Equity Agreement, the Company entered into an Amended and Restated Loan and Security Agreement (the Amended Credit Facility) with its senior lender. Under the Amended Credit Facility, the Company restructured several of its financial and operational covenants, delayed the amortization of the principal balance and provided for paid-in-kind interest through October 2003. In addition, the senior lender waived all prior existing defaults under the Amended Credit Facility. In return, at the closing of the Amended Credit Facility, the Company paid a structuring and arrangement fee of $100,000 and issued to the senior lender a Warrant to purchase up to 333,339 shares of Lightship's Common Stock at an exercise price of $1.00 per share (subject to adjustment as set forth therein). The warrants were

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

fair valued at $3,333 and recorded as interest expense in 2002. The applicable margins on LIBOR and base rate loans were increased by 0.25%. During the years ended December 31, 2003 and 2002, the effective interest rate on the average outstanding borrowings under the Amended Credit Facility were 6.25% and 6.81 %, respectively.

As part of the Amended Credit Facility, the Company is subject to various financial and other covenants. At December 31, 2003, the Company was in compliance with all financial and operating covenants under the Amended Credit Facility.

Aggregate principal maturities of the outstanding long-term debt and capital leases are as follows:

Fiscal Year	
2004	$2,787,769
2005	5,563,489
2006	6,251,160
2007	6,243,711
2008	6,933,769
Thereafter	-
	$27,779,898

In obtaining the Amended Credit Facility, the Company incurred $815,000 of financing costs in 2000, which have been capitalized and were being amortized over the term of the agreement. During 2001 and 2002, the Company incurred $1,095,671 in financing costs associated with negotiating and consummating the Amended Credit Facility. Upon closing the Amended Credit Facility, the unamortized balance of the original financing costs were added to the additional financing costs and amortized over the remaining six-year term. Concurrently, accumulated amortization related to the original financing costs was written-off against the asset. Accumulated amortization was $457,270 and $207,850 related to these costs at December 31, 2003 and 2002, respectively. During 2003 and 2002, the Company charged $249,420 and $232,121 to interest expense, respectively.

On March 25, 2004, the Company restructured several of its financial and operational covenants under the Amended Credit Facility. In connection with the restructuring, the Company paid a restructuring and arrangement fee of $130,000 and incurred legal fees on behalf of the Senior Lender totaling $8,600 which are not reflected in the accompanying financial statements.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

The Company leases certain equipment under long-term leases. During 2003 and 2002, the Company acquired office equipment by entering into long-term capital leases for $37,720 and $14,794, respectively. The related obligations are included in long-term debt. Property and equipment include the following amounts for leases that have been capitalized:

	2003	**2002**
Equipment	**$669,050**	$631,330
Less accumulated depreciation	**455,226**	331,963
	$213,824	$299,367

Future minimum lease payments on noncancelable capital leases at December 31, 2003 are as follows:

Fiscal Year	
2004	$19,449
2005	19,449
2006	11,438
2007	3,426
2008	-
Thereafter	-
Total minimum payments	53,761
Less amounts representing interest	8,940
Present value of minimum lease payments	44,822
Less current payments	14,261
	$30,561

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

6. Commitments and Contingencies

The Company leases its office and switch facilities and certain equipment under non-cancelable operating leases expiring at various times through February 2011. Future minimum payments for the leases are:

Fiscal Year	
2004	$ 829,259
2005	843,251
2006	845,828
2007	352,780
2008	136,934
Thereafter	290,987
	$3,299,039

The total rental expenses charged to operations were $1,156,802 and $1,158,850 in 2003 and 2002, respectively.

7. Stockholders' Equity (Deficit)

On February 8, 2002, the Company executed a securities purchase agreement (the Equity Agreement) with Megunticook Fund II, LP; Megunticook Side Fund II, LP; J.P. Morgan SBIC LLC; Sixty Wall Street SBIC Fund, L.P. and other investors. Under the terms of the Equity Agreement, the Company received $12,690,000 in exchange for 12,690,000 shares of Series CC Voting Convertible Preferred Stock (Series CC) of the Company.

In connection with the closing of the transactions under the Equity Agreement, the principal balance of the subordinated notes outstanding and all accrued interest relating to the subordinated notes were converted into 7,526,882 shares of Lightship's Series BB Convertible Preferred Stock (Series BB). The holder of the subordinated notes was a stockholder in the Company before and after the conversion.

Immediately prior to the execution of the Equity Agreement, Lightship filed with the State of Delaware an Amended and Restated Certificate of Incorporation (Amended Certificate of Incorporation) effecting the recapitalization of its capital stock. The total number of shares of capital stock that Lightship is authorized to issue is 125,000,000, of which 60,000,000 shares are Common Stock and 65,000,000 shares are Preferred Stock, all having a par value of $0.0001 per share. Under the recapitalization, all shares of former Series A Preferred Stock issued and outstanding were exchanged into 5,645,161 shares of newly authorized Series BB; all shares of

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

7. Stockholders' Equity (Deficit) (continued)

former Series B Preferred Stock issued and outstanding were exchanged into 827,957 shares of newly authorized Series BB; all shares of former Series C Preferred Stock issued and outstanding were exchanged into 1,388,889 shares of newly authorized Series CC; and all shares of former Series D Preferred Stock issued and outstanding were exchanged into 48,710 shares of newly authorized Series AA Convertible Preferred Stock (Series AA).

Each holder of Series CC is entitled to receive dividends accruing from the date of issuance at a 10% rate per annum, compounded semiannually, and Series CC shares may be redeemed upon certain redemption events as defined in the Amended Certificate of Incorporation. Each series of preferred stock has certain rights, privileges and preferences in liquidation as outlined in the Amended Certificate of Incorporation.

The shares of Series CC issued in exchange for the former Series C Preferred Stock are subject to a four-year vesting schedule outlined in the individual Award Agreements. The shares of Series AA issued in exchange for the former Series D Preferred Stock are subject to the vesting schedule per the original grant of Series D Preferred Stock. The following chart summarizes the number of shares issued in conjunction with the recapitalization, which are subject to a vesting schedule, and the outstanding and vested shares thereof at December 31, 2003:

Class of Shares	Shares Issued	Shares Repurchased	Shares Outstanding	Shares Vested
Series CC	1,388,889	87,438	1,301,451	1,046,807
Series AA	48,710	4,924	43,786	42,265

Convertible Preferred Stock

In conjunction with the Amended Certificate of Incorporation, the Company exchanged all then-outstanding series of existing preferred stock (Old Series Preferred Stock) for New Series Preferred Stock. The rights and privileges of the New Series Preferred Stock is as follows:

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

7. Stockholders' Equity (Deficit) (continued)

Conversion Rights

At any time, any holder of the Series AA, Series BB or Series CC shall have the right to convert all or any portion of their holdings in Series AA, Series BB and Series CC into shares of common stock at the Conversion Price at the date of conversion. Upon such conversion, the Company shall pay the holders of the Series CC all accrued but unpaid dividends as of the conversion date to be converted in cash, or upon the election of the Series CC holders, payments of dividends in kind, by issuing such number of additional shares of common stock as shall equal the quotient of the accrued but unpaid dividends on the converted shares divided by the Conversion Price then in effect.

Each share of Preferred Stock shall be automatically converted into such number of shares of common stock in the formulas identified above, immediately upon the consummation, on or before February 8, 2007, of the Company's sale of its shares of common stock in a firm commitment underwriting pursuant to a registration statement on Form S-1 declared effective under the Securities Act of 1933, as amended, which results in aggregate cash proceeds to the Company of not less than $25,000,000 and a per share offering price of at least five times the designated base price of the Series CC, as adjusted. In addition, each share of Series AA, BB and CC, as the case may be, shall be automatically converted into such number of shares of common stock upon the election of the Series BB Majority Holders, with respect to the conversion of the Series AA and the Series BB, and the Series CC Supermajority Holders, with respect to the conversion of the Series CC.

Dividends

Each holder of shares of Series CC shall be entitled to receive, prior and in preference to the declaration or payment of any dividend or distribution to the holders of any of the other securities, dividends on each share of Series CC then outstanding at a rate of 10% per annum. Through December 31, 2003, the Company has cumulatively accrued dividends on the Series CC of $2,205,403.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

7. Stockholders' Equity (Deficit) (continued)

Liquidation

In the event of any liquidation, dissolution or winding up of the Company, either voluntarily or involuntarily, including a change in control, each holder of Series CC shall receive, after the payment of the Company's obligations, in cash, a payment of two times the Series CC base price and all accrued but unpaid dividends. Following the distribution to the holders of Series CC, the holders of Series AA and BB shall be entitled to receive, in preference to the holders of any Common Stock, an aggregate amount in cash equal to the product of (x) the number of shares of Series BB outstanding and (y) $2.65714285. The payment will be apportioned among the Series AA and BB holders on a basis as follows: each holder of Series AA shall receive such holder's pro rata portion (in proportion to the total number of shares of Series AA outstanding) of 10% of the total amount to be distributed, while each holder of the Series BB shall receive such holder's pro rata portion (in proportion to the total number of Series BB outstanding) of the remaining payment.

Voting

The holder of each share of voting Series AA, BB and CC shall have the right to one vote for each share of Common Stock into which such share of voting Series AA, BB and CC could then be converted.

Redemption Rights

Within 60 days following the receipt of a written demand by more than two-thirds of the then-outstanding shares of Series CC, at any time after the earlier of February 8, 2007 and the date of any Redemption Event defined by the Amended and Restated Articles of Incorporation, the Company shall redeem all, but not less than all, of the then-outstanding shares of Series CC, for a per share price of equal to the greater of (i) the sum of two times the designated base price of the shares, and the accrued but unpaid dividends on such Series CC, and (ii) the sum of (x) the number of shares of Common Stock into which the Series CC is convertible times the fair market value of a share of common stock at the redemption date and (y) the accrued but unpaid dividends on such Series CC.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

8. Equity Incentive Plan

On February 8, 2002, the Board of Directors adopted the Lightship Holding, Inc. 2002 Equity Incentive Plan (Plan). The Plan is administered by the compensation committee of the Board of Directors. Under the Plan, there are 4,872,949 shares of Series AA eligible for distribution in the form of restricted stock, Incentive Stock Options (ISOs) or nonqualified options. All Series AA issued as restricted stock are subject to the terms and conditions contained in the individual Restricted Stock Award Agreements, including a four-year vesting schedule for unvested shares at the time of grant.

Unearned compensation related to the restricted shares is reported as a deduction to shareholders' equity (deficit). For accounting purposes, compensation expense is recorded ratably over the vesting period. Compensation expense related to these grants was $6,736 in 2003 and $10,424 in 2002.

The ISOs granted are subject to the terms and conditions outlined in the individual Option Award Agreements. In general, the options have a maximum term of 10 years from the date of grant, unvested options at the time of issuance vest over a four-year period, and the exercise price per share is specified in the Option Award Agreement. This price approximates fair value at the time of grant. There was no compensation expense related to ISOs recorded in 2003 or 2002. There were no ISOs exercised during 2003 or 2002.

Upon termination of employment, the Company may purchase all unvested restricted stock or options from an employee for $1. As of December 31, 2003, the Company had 668,828 shares of Series AA available for grant under the 2002 Stock Option Plan.

Lightship Holding, Inc.

Notes to Consolidated Financial Statements (continued)

8. Equity Incentive Plan (continued)

The following chart summarizes the activity under the Plan during 2002 and 2003:

	Shares	Exercise Prices	Weighted Average Exercise Price
Outstanding at December 31, 2001	-	$ -	$ -
Granted	671,005	.01	.01
Exercised	-	-	-
Canceled	(47,800)	.01	.01
Outstanding at December 31, 2002	623,205	.01	.01
Granted	1,269,500	.01-.10	.08
Exercised	-	-	-
Canceled	(99,200)	.01-.10	.01
Outstanding at December 31, 2003	1,793,505	$ .01-.10	$ .01
Exercisable at December 31, 2001	-	$ -	$ -
Exercisable at December 31, 2002	138,363	$ .01	$ .01
Exercisable at December 31, 2003	439,232	$ .01	$ .01

Lightship Holding, Inc.
Consolidated Balance Sheets

	December 31	
	2004	2003
Assets	Unaudited	Audited
Current assets:		
Cash and cash equivalents	$5,731,367	$ 5,806,845
Accounts receivable, net of allowance of $893,218 and $684,087, respectively	3,599,473	3,339,762
Unbilled revenues	1,981,913	1,995,874
Current portion of installation charges, net	547,209	555,778
Prepaid expenses and other assets	1,924,302	370,593
Total current assets	13,784,264	12,068,852
Property and equipment, net	12,925,653	16,203,606
Long-term portion of installation charges, net	461,204	566,093
Long-term deposits and other	354,870	248,319
Debt financing costs, net	1,197,529	1,247,099
Total assets	$28,723,520	$ 30,333,969
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Current portion of long-term debt, including capital lease obligations	$6,530,825	$ 2,787,769
Accounts payable	4,376,916	2,223,183
Accrued payroll	1,757,058	1,243,757
Accrued interest	359,260	66,549
Accrued expenses	1,221,608	3,916,274
Deferred revenue	701,246	783,072
Total current liabilities	14,946,913	11,020,604
Long-term deferred revenue	79,418	287,541
Long-term debt, including capital lease obligations	19,562,313	24,992,129
Total liabilities	34,588,644	36,300,274
Commitments and contingencies (*Note 6*)	-	-
Stockholders' equity (deficit):		
Series CC Convertible Redeemable Preferred Stock; 30,000,000 shares authorized; 13,991,451 and 13,991,451 issued and outstanding at December 31, 2004 and 2003, respectively, $0.0001 par value	1,399	1,399
Series BB Convertible Preferred Stock; 30,000,000 shares authorized; 14,000,000 issued and outstanding; $0.0001 par value	1,400	1,400
Series AA Convertible Preferred Stock; 5,000,000 shares authorized; 2,732,015 and 2389,860 issued and outstanding at December 31, 2004 and 2003, respectively, $0.0001 par value	273	239
Additional paid-in capital	56,171,268	53,804,691
Accumulated deficit	(62,036,265)	(59,767,770)
Deferred compensation	(3,199)	(6,264)
Total stockholders' deficit	(5,865,124)	(5,966,305)
Total liabilities and stockholders' deficit	$ 28,723,520	$ 30,333,969

Lightship Holding, Inc.
Consolidated Statements of Operations

	Year ended December 31	
	2004	**2003**
Revenue	**$51,233,999**	$42,756,089
Cost of sales	**20,278,600**	16,764,424
Operating expenses:		
Sales and marketing	**6,231,973**	5,472,425
General and administrative	**14,559,399**	15,085,306
Depreciation and amortization	**7,791,156**	6,827,263
Total operating expenses	**28,582,528**	27,384,994
Operating profit (loss)	**2,372,871**	(1,393,329)
Interest income	**44,868**	51,969
Interest expense	**(2,386,583)**	(2,375,619)
Net profit (loss) before change in accounting	**31,156**	(3,716,979)
Cumulative effect of change in accounting principle (*Note 2*)	**-**	(544,254)
Net profit (loss)	**$31,156**	$ (4,261,233)

Lightship Holding, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Deficit)

	Series CC Preferred Stock		Series BB Preferred Stock		Series AA Preferred Stock		Additional Paid-In	Accumulated	Deferred	
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Deficit	Compensation	Total
Balance at December 31, 2002	14,078,889	$1,408	14,000,000	$1,400	2,704,064	$270	$52,306,333	$(54,005,078)	$(16,141)	$(1,711,808)
Accretion of Series CC Preferred Stock dividend							1,501,459	(1,501,459)		-
Deferred compensation									6,736	6,736
Repurchase of restricted Series CC Preferred Stock	(87,438)	(9)					9			-
Repurchase of restricted Series AA Preferred Stock					(314,204)	(31)	(3,110)		3,141	-
Net loss								(4,261,233)		(4,261,233)
Balance at December 31, 2003	13,991,451	$1,399	14,000,000	$1,400	2,389,860	$239	$53,804,691	$(59,767,770)	$ (6,264)	$ (5,966,305)
Accretion of Series CC Preferred Stock dividend							2,299,651	(2,299,651)		-
Deferred compensation									3,065	3,065
Issuance of restricted Series AA Preferred Stock					370,979	37	66,927			66,964
Repurchase of restricted Series AA Preferred Stock					(28,824)	(3)	(1)			(4)
Net profit								31,156		31,156
Balance at December 31, 2004	13,991,451	$1,399	14,000,000	$1,400	2,732,015	$273	$56,171,268	$(62,036,265)	$ (3,199)	$ (5,865,124)

Lightship Holding, Inc.
Consolidated Statements of Cash Flows

	Year ended December 31 2004	2003
Operating activities		
Net profit (loss)	**$31,156**	$(4,261,233)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	**7,659,275**	6,827,263
Amortization of debt issuance costs	**308,373**	249,420
Bad debt expense	**656,484**	1,500,425
Other non-cash items	**3,065**	6,736
Changes in operating assets and liabilities:		
Accounts receivable	**(2,126,660)**	(1,537,060)
Unbilled revenue		(948,869)
Prepaid expenses and other current assets	**(435,835)**	(93,990)
Accounts payable	**1,520,104**	(1,335,423)
Deferred revenue		790,847
Accrued liabilities	**(677,178)**	1,441,849
Net cash provided by (used in) operating activities	**6,938,783**	2,639,965
Investing activities		
Payments for purchase of property and equipment	**(4,526,609)**	(3,149,752)
Payments for installation charges	**(609,051)**	(949,605)
Net cash used in investing activities	**(5,135,660)**	(4,099,357)
Financing activities		
Proceeds from borrowings	**1,500,000**	1,501,485
Principal repayments of borrowings and capital leases	**(3,186,759)**	(91,951)
Payment of deferred financing costs	**(195,303)**	-
Proceeds from exercise of stock options	**3,461**	-
Net cash provided by financing activities	**(1,878,601)**	1,409,534
Net increase (decrease) in cash and cash equivalents	**(75,478)**	(49,858)
Cash and cash equivalents at beginning of year	**$ 5,806,845**	5,856,703
Cash and cash equivalents at end of year	**$5,731,367**	$ 5,806,845
Supplemental disclosures of cash flows		
Cash paid for interest	**$1,569,352**	$ 781,550
Noncash investing and financing activities		
Acquisition of equipment under capital leases	-	$ 37,720
Equipment purchases included in accounts payable and accrued expenses	**$510,205**	$ 1,378,001

<u>Schedule 4(h)(ii) - Other Liabilities</u>

(ii) Lightship is currently analyzing whether USF contributions and FET are owed by Lightship with respect to the following matters for each calendar year in which Lightship has been engaged in the Business: (i) USF contributions on PICC charges on voice lines, (ii) USF contributions on EUCL charges, (iii) FET on USF charges, (iv) FET on voice PICC charges, and (v) FET on EUCL charges on voice lines. To the extent that Lightship and its independent accountants determine in good faith that a current Liability is to be recorded on Lightship's balance sheet with respect to these matters, such Liabilities, and only such Liabilities, shall be deemed to have been disclosed in this Disclosure Schedule.

(iii) The State of Maine is auditing Sales and Use taxes paid by Lightship by reviewing monthly filings for May 1, 2001 - March 31, 2004. The work is not complete and no adjustments have yet been proposed. A $30,000 reserve for the payment of any Liability relating to this audit has been included in the Most Recent Financial Statements. Lightship believes that such reserve is sufficient to cover any Liability that results from the audit.

Schedule 4(i) - Legal Compliance

(i) See Schedule 4(e)(iii).

(ii) See Schedule 4(h)(ii).

(iii) See Schedule 4(j).

(iv) See Schedule 4(l).

Schedule 4(j) - Tax Matters

Schedule 4(j)(i) - Extensions to File Tax Returns

Extensions for the 12/31/2004 federal and state income Tax Returns were filed on March 15, 2005.

Schedule 4(j)(ii) - Withholding Taxes

None

Schedule 4(j)(iii) - Payment of Taxes

Lightship is currently analyzing whether USF contributions and FET are owed by Lightship with respect to the following matters for each calendar year in which Lightship has been engaged in the Business: (i) USF contributions on PICC charges on voice lines, (ii) USF contributions on EUCL charges, (iii) FET on USF charges, (iv) FET on voice PICC charges, and (v) FET on EUCL charges on voice lines. To the extent that Lightship and its independent accountants determine in good faith that a current Liability is to be recorded on Lightship's balance sheet with respect to these matters, such Liabilities, and only such Liabilities, shall be deemed to have been disclosed in this Disclosure Schedule.

Schedule 4(j)(v) - Pending Taxing Authority Audits

The State of Maine is auditing Sales and Use taxes paid by Lightship by reviewing monthly filings for May 1, 2001 - March 31, 2004. The work is not complete and no adjustments have yet been proposed. A $30,000 reserve for the payment of any liability relating to this audit has been included in the Most Recent Financial Statements. Lightship believes that such reserve is sufficient to cover any Liability that results from the audit.

Schedule 4(j)(vi) - Reserves for Tax Liability

Lightship is currently analyzing whether USF contributions and state and FET are owed by Lightship with respect to the following matters for each calendar year in which Lightship has been engaged in the Business: (i) USF contributions on PICC charges on voice lines, (ii) USF contributions on EUCL charges, (iii) FET on USF charges, (iv) FET on voice PICC charges, and (v) FET on EUCL charges on voice lines. To the extent that Lightship and its independent accountants determine in good faith that a current Liability is to be recorded on Lightship's balance sheet with respect to these matters, such Liabilities, and only such Liabilities, shall be deemed to have been disclosed in this Disclosure Schedule.

Schedule 4(j)(viii) - Requests for Rulings by Taxing Authorities

None

Schedule 4(j)(xx) - Jurisdictions Where Lightship Companies are Required to Pay Taxes or File Returns

- Maine
- New Hampshire
- Vermont
- Massachusetts
- Rhode Island
- Pennsylvania
- Delaware
- New Jersey
- New York
- Connecticut

Schedule 4(j)(xxi) Material Elections with Respect to Taxes

None

Schedule 4(k) - Contracts

Schedule 4(k)(i)(A) - Real Property Leases

Property	Landlord	Current Monthly Rate	CAM	SQ FT
Maplewood Office Park, Fort Washington, PA. Suite 120	Maplewood Office Center Limited Partner	$6,135.75	$1,537.00	3,636
Maplewood Office Park, Fort Washington, PA. Suite 440	Maplewood Office Center Limited Partner	$6,517.13	$1,573.00	3,862
340 Cumberland Ave. Portland, ME.	340 Associates, L.L.C.	$7,152.50	$932.01	5,722
190 Riverside St. Portland, ME	Bounty Realty	$1,989.75	$602.19	2,274
One Executive Park Drive, Bedford NH 1ST Flr	Bedford, New Hampshire Associates	$8,176.50	$705.00	5,451
One Executive Park Drive, Bedford NH 2ND Flr	Alliance Resources	$24,650.17	$6,450.47	19,084
55 Bridge Street Manchester, NH	55 Bridge St Associates, Inc.	$2,815.60		1,868
100 Bank Street Burlington VT Suite 210	Burlington Seven Associates Limited Partnership	$1,606.17	$80.26	1,676
400 Cornerstone Drive Williston VT	Allen Brook Development Inc.	$2,163.79	$602.60	2,225
100 Bank Street Burlington VT 1st Floor	Burlington Seven Associates Limited Partnership	$2,578.37	$74.08	1,547
281 Winter Street, Waltham, MA	Somerset Court, Inc.	$5,915.00	$303.33	3,640
44 Front Street Worcester, MA	Chase Building Associates, L.P.	$8,258.95	$671.37	6,835
583-585 East Columbus Ave Springfield, MA	Colebrook Partners South, LLC	$1,723.33	$1,276.92	2,350
177 Old River Road Lincoln, RI	PK Ventures LLC	$5,374.00		3,593

Schedule 4(k)(i)(B) - Personal Property Leases with annual payments > $10,000

(i) the Master Lease Agreement
(ii) Ford Motor Credit Lease
(iii) Konica / Wells Fargo
(iv) Leaf Financial

Schedule 4(k)(i)(C) - Contracts with annual payments > $30,000

Party Name	Contract Title	Effective Date
ADP	Payroll Services	n/a
Adtran, Inc.	Letter of Agreement	1-Apr-04
Aptis, Inc.	Master License Agreement	n/a
AT&T	Internet Transport Services	9-Feb-05
Cable and Wireless	Internet Access	2-Jun-04
CallVision.com, Inc.	Agreement	Month-to-Month
Contact Telecom, LLC	BDA Services	Month-to-Month
Covad Communications Company	Broadband Internet Access Services Agreement	11-Mar-04
Electronic & Unit Record Data Center Inc.	Agreement for Bill Print and Fulfillment Services	15-Apr-04
Electronic & Unit Record Data Center Inc.	Master License Agreement	n/a
Ernst & Young LLP	Annual Audit and Tax Returns	Annual
Fiber Technologies Networks LLC	Master Facilities Agreement	9-Mar-04
Frontier Communications of the West, Inc.	Carrier Services Switchless Agreement	25-Jan-99
Illuminet, Inc. (now Verisign)	Master Service Agreement	Sep-99
Invivo	Letter of Engagement - Billing Recovery	2004
MCI Worldcom Network Services Inc.	Attachment for Private Line Services	4-Aug-03
MCI Worldcom Network Services Inc.	Dedicated Internet Access Service	10-Jul-03
MCI Worldcom Network Services Inc.	Telecommunications Services Agreement	14-May-02
MetraTech Corp.	Hosting Services Agreement	n/a
Mid-Maine TelPlus d/b/a Mid-Maine Communications	Telecommunications Service Agreement Business (Non-Residential)	3 years per circuit
Nortel Networks	Annual Software Support Agreement for DMS 100	7-Jan-05
Nortel Networks	Master Purchase Agreement	19-Feb-99
Nortel Networks	Support Services and Patch Management	1-Apr-04
Northeast Competitive Access Provider LLC	Carrier Service Agreement	14-Jan-02
Northeast Optic Networks, Inc.	Agreement	Signed 1/31/00
Northridge Group, Inc.	Consultant Master Agreement	2004
Paradyn Corp.	Master Service Agreement	1-Jan-05
RNK, Inc. d/b/a/ RNK Telecom	Carrier Services Agreement - Terminations	23-Dec-02
Ronco	Purchase of PBX/ Maintenance - Boston Wireless	27-Jan-99
SCC Communications	TeleConnect Services Agreement	1-Dec-00
Secured Servers, LLC	Master Service Agreement	30-Mar-04
Sponsor A Highway, Inc.	Sponsor Agreements	Multiple

Party Name	Contract Title	Effective Date
Sprint Communications Company L.P.	Wholesale Services Data & Private Line	Not in use
Sprint Communications L.P.	Wholesale Services Data and Private Line Agreement	18-Aug-03
Verizon Global Solutions Inc.	Carrier Services Agreement	29-Dec-03
Verizon Network Integration Corp.	Dedicated Internet Access Service Agreement	23-Jan-03
Verizon New England Inc.	Conduit License Agreement (New Hampshire)	28-Feb-05
Verizon New England Inc.	Conduit License Agreement (Vermont)	24-Aug-04
Vertex, Inc.	Software License Agreement	27-Dec-02
Walker & Associates	Agreement of Purchase Exclusivity	1-Oct-04

Schedule 4(k)(i)(D) -Maintenance Contracts

Party Name	Contract Title	Effective Date
Equinox Information Systems	Equinox Software Annual Maintenance Contract	16-Jul-05
GFI USA, Inc.	Software Maintenance Contract for Exchange/SMTP	Unknown
Help/Systems, Inc.	Alert and Console	12-Mar-04
IBM	Customer Agreement	6-Jan-05
ILD Telecommunications Inc.	Operator Services Agreement	24-Jul-02
Microsoft	Exchange, Windows, Visio, Vstudio, SQL	Multiple
Solunet, Inc.	Service Support Contract for Lucent, Cisco Equipment	2-Apr-04
Sterling Commerce (America)	Connect Software License Agreement	10-Mar-00
Surebridge	Annual Renewal and Support Plan	24-May-04
Symantec	Maintenance License	19-Jan-05
Tax Partners, Inc.	General Tax Filing	2002
Technical Differences, Inc.	Software, Components and Training	13-Oct-03
TelJet Inc.	Master Service Agreement	Approx. 6/17/04
Voyant Technologies, Inc.	Peak Performance Pack - Maintenance and Support Agreement	1-Jul-04

Schedule 4(k)(i)(F) -Other Material Contracts

Party Name	Contract Title	Effective Date
Balanced Air Systems	HVAC Preventive Maintenance	17-Sep-04
Granite Systems, Inc.	Maintenance Services Agreement	2-Jan-02
Interstate Fire Protection	Service Contract	9-Jun-04
Southworth Milton	Annual Service Contract and Maintenance Program	Annual
Universal Access, Inc.	Lattis Service Agreement	14-Nov-01

Schedule 4(k)(iii) - Customer Agreements

See PDF files on CD-ROM containing all Customer Agreements as of February 15, 2005 and March 1, 2005

Currently all of Lightship's interconnection agreements with Verizon have expired. Per industry practices, Lightship and Verizon continue to operate pursuant to the terms of the interconnection agreements on a month-to-month basis. In addition, per industry practice, Lightship and Verizon will continue to operate on a month-to-month basis pursuant to the terms of the interconnection agreements until the agreements are renegotiated. Lightship expects to renegotiate these agreements once the TRRO implementation has completed. Lightship has not received notice from Verizon of Verizon's intent to terminate the month-to-month operation of the interconnection agreements.

Schedule 4(l) - Litigation

(i) BCN Objection to Lightship Claim And Request for Damages for Willful Violation of Stay Order

Menty's d/b/a Berkshire County Networks ("BCN") was an ISP customer in Western MA who filed for Chapter 11 bankruptcy protection in October 2003 owing Lightship approximately $138,000.

Prior to BCN's voluntary filing, Lightship had attempted to collect the amounts owing and concluded that BCN was not willing or able to enter into a satisfactory payment plan. Upon reaching that conclusion, Lightship initiated the MA PUC process to discontinue service, namely by sending a 10-day demand letter followed by a 6-day demand letter.

The 10-day letter was sent before the Chapter 11 filing. Following the filing, BCN continued to receive telecom services from Lightship and indicated to Lightship that it had no intention of paying either pre-petition or post-petition claims. On advice of counsel, Lightship sent the 6-day demand letter and subsequently terminated service. In accordance with the terms of the contract with BCN, Lightship charged a breach fee of approximately $208,000, the fixed charge portion of the remaining contract period.

In October 2004, BCN filed the motion cited above seeking unspecified damages. Lightship filed a response disputing all elements of the claim.

In January 2005, the Court continued the hearing on the Claim and Response until January 26, 2005. On February 28, 2005, Lightship received a First Request for Production of Documents to Lightship Telecom LLC. Lightship has 30 days from the date of service to respond.

(ii) The Hartford Insurance Company (The Hartford) v. Lightship Telecom, LLC. (Worker's Compensation Policy No. 04WB1F5515; General Liability Policy No. 04UUNGW7505K1)

The Hartford has hired the Wells Law Office of White River Junction, VT, to pursue collections related to disputed premiums for the policies referenced above. The amounts total approximately $145,206.

During The Hartford's audit to determine Lightship's final Audited Premium for the policies listed above, The Hartford misclassified Lightship workers, resulting in higher premiums for both the Worker Compensation Policy and the General Liability Policy. The Hartford classified Lightship field employees under the code of 7600. The work description for this code is "Telephone personnel other then those employees working within the office or exchanges.... In most instances, operations associated with line construction, include right of way clearance, pole erection, laying underground cable,

etc…" As a CLEC, Lightship does not own lines nor is it involved in the construction or erection of lines. Lightship employees work within offices and exchanges. Therefore Lightship should have been coded consistent with its current classification of 5191.

Lightship, Lightship's current insurance provider (Herbert L. Jamison & Co., LLC), and Lightship's current counsel assigned to this issue (Wadleigh, Starr & Peters) view The Hartford's case as immaterial and unsubstantiated.

Schedule 4(m) - Employees

See attached list of salaries and bonuses.

See attached summary of severance obligations.

Kevin O'Hare's employment is governed by the terms of the Executive Employment Agreement.

Schedule 4(n) - Employee Benefit Plans

Medical Benefits

- New England employees may choose from **Anthem Blue Cross Blue Shield** HMO (health maintenance organization) or POS (point of service) plan.
-
    - The HMO plan has in-network benefits of $15 office visit co-pay and prescription co-pays of $5, $15, and $25 for generic, formulary brand, and non-formulary brand (respectively).
    - The POS plan has the same in-network benefits as the HMO, plus self-referred benefits of 80% coinsurance with a $500 deductible per person per year (up to $1500 per family).
- Pennsylvania employees are eligible for coverage under Keystone Health Plan East, a POS plan, Personal Choice or Anthem's preferred Blue plan.All plans offer prescription drug benefits as well as a multitude of other benefits such as discounts/reimbursement for smoking cessation, gym membership, Weight Watchers, etc.
- All of the medical plans also offer coverage for vision exams, as well as discounts for eyewear.
- Lightship co-insures employees for approximately 75% of the medical costs.
- Employees are eligible for medical benefits on the 1st of the month following 60 days of full-time regular employment. Open enrollment is March 1 each year.

Dental Benefits

- Employees may choose from two levels of coverage through Lightship's dental plan, Assurant Dental. Since the plan is an indemnity plan, members may visit the participating dentist of their choice. The dental plan is primarily employee funded.
    - The **Pro One** plan offers 100% coinsurance (up to the Maximum Allowable Benefit) for routine, preventive services such as examinations and cleanings; and 80% coinsurance for services such as fillings, complete x-rays, and extractions.
    - The **Pro Three** plan offers the same coverage as the Pro One plan, plus additional coverage for complex oral surgery, crowns, dentures, and orthodontia (applies only to children under age 19).
- Employees are eligible for dental on the 1st of the month following 60 days of full-time regular service. Open enrollment is August 1 each year.

Flexible Spending Account (FSA)

- Health care and dependent care FSAs through FlexBen can be used to pay for health care and dependent care expenses on a pre-tax basis. Each year, employees may contribute up to $5,000 of pre-tax money to each account through payroll deductions.

- Participants can access 100% of their annual contribution to the Healthcare account immediately. For the dependent care account, reimbursements are made based on the actual dollar amount contributed to the account to date.

- Participants experience the convenience of using a debit card to pay for applicable expenses.

- Employees with 90+ days of service are eligible for enrollment in the FSA. Enrollment entry dates are August 1 and February 1.

Disability Insurance

- Lightship fully funds the UnumProvident employee **short-term disability** plan. Benefits include salary continuation of 60% of your weekly salary to a maximum of $500.

- Employees have two options for **long-term disability** insurance. The first level of coverage is fully funded by Lightship and includes salary continuation of 50% of your salary to a monthly maximum of $5,000. Employees may also opt for a higher level of coverage which includes salary continuation of 2/3 your salary to a monthly maximum of $10,000. This option is funded both by Lightship and employee contributions.

Life Insurance

- Life Insurance is through UnumProvident. Employees may elect several different coverage options:
-
    - Company-funded coverage of 1x annual salary to a maximum of $50,000; OR

    - Up to an additional 4x annual salary. The employee contributions for additional coverage vary depending on annual salary and age.

401(k) Plan

- Lightship offers a 401(k) plan administered through BISYS Retirement Services.
- There is an employer match of 50% up to the first 3% of employee contributions. Vesting is based on years of service.
- Participants may choose up to 14 different funds in which to invest.
- Participants have access to their fund information at any time via a toll-free number and website.
- Employees over the age of 21 who have 3 months+ of service to Lightship may enroll quarterly.

529 College Savings Plan

- Allows participants to save for college expenses through payroll deductions.
- Interest earned on 529 account savings is tax-free, and when used for qualified higher education purposes, distributions are free from federal income tax.
- Employees with 90+ days of full-time regular service may enroll in the 529 Plan at any time.

Paid Time Off (PTO)

- Employees may earn up to 3 weeks (15 days) of Paid Time Off per calendar year. 1/26th the annual allowance is earned with each biweekly pay period.
- Full-time regular employees are eligible to use PTO after 90 days of service.

Holidays

- There are typically 10 paid holidays per calendar year, including a birthday holiday (to be taken any day in the month of your birthday).

Maternity & Paternity Leave

- Maternity: Qualified employees on maternity leave receive short-term disability (STD) payments that equal 60% of weekly salary up to $500/week. Lightship will compensate the employee for the remaining difference in their salary that the STD insurance does not cover, for a maximum of six (6) weeks.

- Paternity: Qualified employees are eligible to receive up to three (3) days of paid paternity leave for the birth or adoption of a child.

Adoption Benefits

Lightship will offer qualified employees financial reimbursement of up to $2,000 for adoption-related expenses, payable when the adoption is finalized. Adoptive parents will also be eligible for up to three (3) days of paid leave.

Severance Benefits

See attached summary of severance obligations.

Schedule 4(n)(v) - Liabilities on Termination

(i) See attached description of fees due upon termination of the 401(k) plan.

(ii) See attached summary of severance obligations.

SCHEDULE 4(n)(v)

Lightship Telecom

March 3, 2005

Lightship 401k Plan

If the plan is terminated:

- Bisys requires at least 90 days written notice prior to the effective date of the termination.
- There is a $250 interim valuation fee payable upon the plan's termination of Bisys' services.
- Plan termination processing fee is $150.
- If Bisys is to assist in the plan termination with the IRS, a $600 fee would apply. This fee may be taken from the plan assets. In addition, Bisys will not complete the Form 5310 to the IRS so an outside source (i.e. legal counsel) would need to perform this task.
- All participants in the plan would become immediately 100% vested.
- Account balances would be distributed to participants upon the termination of the plan. Participants would have the option to rollover their account balances to another qualified plan or IRA or take a lump sum distribution.

If the plan is moved from Bisys and merged with another plan with a new provider/trustee:

- Bisys requires at least 90 days written notice prior to the effective date of the termination.
- A blackout period may apply while participant records and account balances transition to the new provider.
- There is a $250 interim valuation fee payable upon the plan's termination of Bisys' services.
- Plan termination processing fee is $150.
- Deconversion exit tape fee of $500.

Estimated Annual Cost of Administering the Plan

- Ongoing Recordkeeping & Reporting Fees (based on # of eligible employees): $3,000 + $15/eligible over 100

Per the 12/31/04 Non-Discrimination Testing, there were 210 eligible employees
(Estimated cost is $3,000 + $1,650) — $4,650

- Annual Trustee Fee: — $300
- Other Misc. Services:
    - Plan Year-End Summary Report (Audit report) — $500
    - Plan refunds required due to failed compliance testing ($100/refund x 7) — $700

Estimated Annual Plan Administration Cost — $ 6,150

Schedule 4(o) Environmental

None

Schedule 4(q) - Accounts; Safe Deposit Boxes

1. Sovereign Bank of New England
75 State Street
Boston, MA 02110

Operating Account
Acct# 61100096967

<u>Authorized Signatories</u>
Kevin O'Hare
Jeff Koester
William Wilson
Rainer Gawlick
Bryon Cail
Eleanor Knott

2. Sovereign Bank of New England
75 State Street
Boston, MA 02110

Flexible Spending Account
Acct# 87900031243

<u>Authorized Signatories</u>
William Wilson
Bryon Cail
Eleanor Knott

3. Sovereign Bank of New England
75 State Street
Boston, MA 02110

Overnight Investment Account
Acct#758600003328

Schedule 4(r) - Transactions with Related Parties

None

Schedule 5(c)(iii) - Employee Agreements

See attached summary of severance obligations.

Schedule 6(b)(ii) - Employee Severance Arrangements

See attached summary of severance obligations.